IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 492

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

BRIEF FOR THE PETITIONER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR THE PETITIONER

Opinions Below.

The opinion of the Circuit Court of Appeals below (R. 128) is reported in 137 F. (2d) 623.

The opinion below (R. 63, 88) of the United States Board of Tax Appeals (now the Tax Court of the United States) is reported in 44 B. T. A. 293.

Jurisdiction.

This proceeding, involving the petitioner's income taxes for 1933, originated in the United States Board of Tax Appeals (now the Tax Court of the United States) which entered its final order of redetermination and decision on July 17, 1941 (R. 93). The judgment of the United States Circuit Court of Appeals affirming that order and decision,

on the issue here presented, was entered August 18, 1943 (R. 134). A petition for a writ of *certiorari* was filed with this Court on November 17, 1943 and allowed by an order entered December 20, 1943 (R. 135).

The jurisdiction of this Court is invoked under Section 1141 of the Internal Revenue Code (53 Stat. 164), and Section 240 of the Judicial Code, as amended (43 Stat. 938).

Question Presented.

Is the petitioner entitled to a deduction under Section 203 (a) (8) of the Revenue Act of 1932 in the amount of the "excess interest dividends" paid within the taxable year, pursuant to the provisions of its supplementary contracts not involving life contingencies?

Statute Involved.

The statute involved is the Revenue Act of 1932 which provides in part as follows (47 Stat. 223, 224 and 225):

> "Sec. 203. Net Income of Life Insurance Companies.
>
> (a) General Rule.—In the case of a life insurance company the term 'net income' means the gross income less—
>
> * * * * * * * * *
>
> (8) Interest.—All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxapayer) the interest upon which is wholly exempt from taxation under this title."

Statement of the Case.

The petitioner is a mutual life insurance company organized and existing under and by virtue of the laws of

the State of New York, having its principal office and place of business in the City of New York and being engaged in the business of issuing and selling life insurance and annuity contracts. At all times more than 50% of its total reserve funds have been held for fulfillment of its life insurance and annuity contracts (R. 105).

During and prior to the calendar year 1933 the petitioner issued life insurance policies which gave to the insured, and in some cases to the beneficiary, the right to require the petitioner to hold the face amount of the policy after the date upon which it would otherwise be payable, supplement this amount with annual increments of interest, and pay out the increased amount in installments or otherwise over varying periods of time (R. 109, 118A). The contracts which evidence the exercise of such options under these provisions are known as "Supplementary Contracts." It has been stipulated (R. 109) and found (R. 69) that the "supplementary contracts" involved herein, consist of "options exercised under provisions 1, 2 or 4 of Stipulation Exhibit D"; and the provisions of these "optional modes of settlement in lieu of the lump sum" payment otherwise provided for in the policy, are set out in "Stipulation Exhibit D" which appears as page 118A of the Record herein (R. 69, 109).

The funds held by the petitioner under the elected optional modes of settlement here involved, which are referred to herein as supplementary contracts, totalled \$34,806,201.00 at the beginning of 1933 and \$42,326,682.00 at the end thereof (R. 69, 109). Less than \$15,000 of these amounts represented accrued but unpaid interest (R. 71, 111), the balance consisting of the unpaid principal of the face amounts of matured policies from which these supplementary contracts were derived (R. 69, 70, 109, 120).

The supplementary contracts provided for interest at the guaranteed rate of 3% per annum and for "excess interest dividends" as follows (R. 74, 118A):

"Excess Interest Dividend: The foregoing Options are based upon an interest earning of 3% per annum; but if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1, the amount of instalment under Option 2, the amount of income during the fixed period of five, ten or twenty years under Option 3 and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society."

It has been stipulated (R. 110) and found (R. 70) that:

"The obligations arising under these option contracts were absolute obligations of the petitioner and were not in any sense contingent upon the happening of future events."

It has been stipulated (R. 122) and found (R. 73) that:

"The excess interest dividends paid by the petitioner on its Supplementary Contracts Not Involving Life Contingencies, accrued and were paid as follows under the different options set out in Stipulation Exhibit D, exercised as indicated:

Option 1	exercised	by	insured	$147,201.05
" 2	"	"	"	82,158.73
" 4	"	"	"	27,386.24
" 1	"	"	beneficiary	229,930.32
" 2	"	"	"	36,158.40
" 4	"	"	"	12,052.80
		Total		$534,887.54"

The excess interest dividends so paid by the petitioner, for which the petitioner claims the deduction here at issue, "*accrued during the year* * * * at the rate declared for the year by its Board of Directors" (R. 72, 113). The *specific rate* at which these excess interest dividends would

accrue and be paid by the petitioner during 1933 was declared "by resolution of its Board of Directors" at *"the beginning of"* that year (R. 72, 112).

The petitioner contends that it is entitled to a deduction under Section 203 (a) (8) for interest paid on indebtedness in the amount of these "excess interest dividends" as well as to the deductions allowed by the court below for amounts so paid as "guaranteed interest."

On brief before the Board, the Commissioner conceded that the petitioner is entitled to a deduction claimed under Section 203 (a) (8), in the amount of guaranteed interest paid on contracts arising from the exercise of Option 1 by either the insured or the beneficiary (R. 81, 82). This is the option under which the face amount of a policy is "left on deposit with the Society at interest" (R. 74, 118A).

The court below affirmed the decision of the Board in allowing the deduction so conceded by the Commissioner; and in allowing a deduction claimed in the amount of guaranteed interest paid on contracts arising from the *beneficiary's* election of Options 2 and 4. The court held it error on the part of the Board to disallow a deduction claimed in the amount of guaranteed interest paid on contracts which arose from the *insured's* election of Options 2 and 4.

The court affirmed the decision of the Board in disallowing the deduction now at issue before this Court, in the amount of the excess interest dividends paid by the petitioner on these contracts in 1933.

This Court granted the petitioner's petition for a writ of *certiorari* to review the decision below in so far as it disallowed the deduction claimed in the amount of the excess interest dividends paid within the year (R. 135).

The respondent has sought no review of the decision below.

Specification of Errors To Be Urged.

1. The Circuit Court of Appeals for the Second Circuit erred in holding that the excess interest dividends which the petitioner determined and paid during the year 1933 on the supplementary contracts here involved do not constitute "interest paid * * * within the taxable year on its indebtedness" for which a deduction is provided by Section 203 (a) (8) of the Revenue Act of 1932 (47 Stat. 225).

2. The said court erred in failing to hold upon the facts as found by the United States Board of Tax Appeals (now the Tax Court of the United States) that the petitioner is entitled in full to the deductions claimed under Section 203 (a) (8) of the Revenue Act of 1932 (47 Stat. 225).

ARGUMENT

The petitioner is entitled to the deduction expressly provided by Section 203 (a) (8) of the Revenue Act of 1932 for "*all* interest paid * * * within the taxable year on its indebtedness" and this includes the excess interest dividends which the petitioner paid in 1933 on the supplementary contracts involved herein.

The Circuit Court of Appeals, in its opinion below (R. 132 and 133), called attention to the conflicting decisions of the Circuit Courts of Appeals for other circuits on the issue here involved.[1] The court, after noting that some of these decisions, and a subsequent Tax Court decision, had allowed the deduction for excess interest dividends,[2] then said (R. 133):

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[1] *Lederer* v. *Penn Mutual Life Insurance Co.* (C. C. A.-3, 1919), 258 Fed. 81 at page 92, affirmed on other issues (1920), 252 U. S. 523;

Commissioner v. *Lafayette Life Insurance Co.* (C. C. A.-7, 1933), 67 F. (2d) 209;

Penn Mutual Life Insurance Co. v. *Commissioner* (C. C. A.-3, 1937), 92 F. (2d) 962, at page 970.

[2] *Lederer* v. *Penn Mutual Life Insurance Co., supra; Commissioner* v. *Lafayette Life Insurance Co., supra; Jefferson Standard Life Insurance Co.*, 44 B. T. A. 314.

"But it seems to us that a payment which may be made or withheld at the will of the directors of the company cannot be regarded as a payment of interest within the strict construction we are bound to adopt in construing an exemption statute."

It appears, therefore, that on the issue now before this Court, the decision below was based upon the lower court's assumption that there was no binding obligation upon the petitioner to pay these excess interest dividends as they accrued in 1933, but that such payments remained within the will of the directors up to the time each such payment was made.

This assumption is directly contrary to the facts as stipulated by the parties (R. 112, 113, 118A) and as found by the Tax Court (R. 67, 72, 73, 74).

The facts so stipulated and found, and discussed under the subsequent headings in this brief, show that:

1. The petitioner held the proceeds of policies under written agreements to pay interest thereon at a minimum rate of 3% every year, which expressly provided that "if *in any year* the Society declares that funds held under such options shall receive interest in excess of 3% per annum, the interest * * * shall be increased *for that year* by an Excess Interest Dividend as determined and apportioned by the Society" (R. 109, 118A, italics supplied).

2. The *specific rate* at which such excess interest dividends would be paid by the petitioner for its retention and use of these funds in 1933 was determined and declared, by resolution of the petitioner's Board of Directors, *at the beginning* of that year (R. 112).

3. At the end of 1933, the petitioner held $42,326,682.00 under supplementary contracts of the

various types here involved, whereas at the beginning of that year it had held but $34,806,201.00 under such contracts (R. 69, 109). In other words, at least $7,520,481.00, or 20% of the funds upon which these excess interest dividends were paid in 1933, were not left with the petitioner under these contracts *until after the petitioner, by resolution of its Board of Directors at the beginning of that year, had determined and declared the specific rate* at which it would pay these so-called excess interest dividends (R. 69, 72, 74, 109, 112, 118A).

4. More than forty-two per cent of the balance of the funds upon which these excess dividends were paid in 1933 were funds which the beneficiaries were privileged to withdraw at any time (R. 112, 118A, 121). These were funds which the *beneficiaries*, not the *insured*, had "left on deposit with the Society at interest" *after the specific rate at which these excess interest dividends would be paid for that year had been determined and declared* (R. 112, 118A, 121). See Point III, *infra*.

5. The excess interest dividends paid by the petitioner in 1933 "*accrued during the year*" (R. 113) solely upon the basis of the respective funds held during that year under the various contracts (R. 118A, 122). They did not accrue and were not paid in one sum, but were paid *as they accrued during the year*, with each monthly or other instalment, as such instalments became due (R. 74, 118A).

6. The petitioner's promise to pay these excess interest dividends, for its retention and use of these funds in 1933, at the specified rate deter-

mined and declared at the beginning of that year, was not conditioned upon whether it had a surplus, nor upon the earnings or profits it might realize (R. 109, 112, 118A).

The *new* supplementary contracts, issued in 1933 under policies which matured in that year, which had been *elected in 1933* by the insured, and all of the *new* supplementary contracts which had been elected by the *beneficiaries*, arose from options *which had not been elected* until *after* the petitioner, *at the beginning of that year*, had declared the specific rate at which it would pay excess interest dividends in that year for its retention and use of funds during that year under supplementary contracts (R. 72, 74, 112, 118A). This is true as to *all* the new supplementary contracts which had been *elected by the beneficiaries*, since the beneficiaries had no right of election until *after* the maturity of their respective policies (R. 73, 118A).

No doubt some of the *new* supplementary contracts issued in 1933, under policies which matured in that year, arose from options elected by the insured in prior years. But at any time prior to the maturity of these policies in 1933, these elections could have been cancelled "by the Insured's written order filed with the Society" (R. 74, 118A). Such cancellations could have been made after the petitioner, *at the beginning of 1933*, had declared *the specific rate* at which it would pay excess interest dividends in that year on the proceeds of policies held during that year under supplementary contracts. All of the insured, now deceased, who had been the holders of the policies from which these *new* supplementary contracts were derived, had been alive at some time in 1933 *after the beginning of that year*. Had they not been satisfied with the specific rate at which the petitioner had then declared that it would pay excess interest dividends on funds left with it during that year under supplementary contracts, those policyholders

could have, and presumably would have, cancelled any elections they had made permitting the petitioner to retain the proceeds of their policies, after maturity, under such contracts.

Each of these new supplementary contracts issued in 1933, therefore, was based upon the mutual understanding that for the balance of that year the beneficiary of the contract would receive not only interest at the guaranteed minimum rate of 3% but also excess interest dividends at *the specific rate* which had been determined and declared *at the beginning of that year.*

Both under these new supplementary contracts and under the supplementary contracts issued in prior years, the petitioner's payment of excess interest dividends constituted, as shown under Point I, *infra,* the payment of interest on its indebtedness, or as held in *United States* v. *Heilbroner* (C. C. A.-2, 1938) 100 F. (2d) 379 at page 381: "Sums paid * * * for the retention and use of the face amounts of the various policies," sums which are "fairly within the meaning of the word 'interest'" as that term is used in the revenue acts. It will also be shown under Point I, *infra,* that these excess interest dividends constituted neither a distribution of surplus nor a sharing of earnings; that the petitioner's undertaking was not conditioned upon the existence of a surplus or of a profit for the year; that the supplementary contracts contemplated and provided for the payment of these so-called excess interest dividends to beneficiaries *who were not entitled to share in the petitioner's surplus, or earnings;* that, accordingly, the Tax Court's decision in *Jefferson Standard Life Insurance Co.,* 44 B. T. A. 314, in which the respondent has acquiesced (CB 1941-2, p. 7), is correct in so far as it holds that a life insurance company is entitled to a deduction under Section 203 (a) (8) of the Revenue Act of 1932 for excess interest paid on its supplementary

contracts; and that the petitioner is, likewise, entitled to the deduction here claimed.

As shown under Point II, *infra,* the petitioner's declaration, at the beginning of 1933, of *the specific rate* at which excess interest dividends would be paid in that year, was a part of the *offer* which, when subsequently accepted, resulted in the *new* supplementary contracts issued in 1933.

Since a beneficiary has no power to elect an option until *after* the maturity of the policy (R. 118A), all new contracts elected by the beneficiaries were elected in 1933 *after* the petitioner had made this offer. Their elections, therefore, constituted acceptances of this offer. Where these new contracts arose from options *elected in 1933* by the *insured,* such elections were likewise made after the petitioner's offer had been made *at the beginning of that year,* and constituted acceptances of that offer.

The balance of these new contracts arose from options elected by the insured in prior years. But the petitioner's declaration of the specific rate at which it would pay excess interest in 1933, was obviously designed and intended to encourage policyholders to refrain from cancelling their elections of options where such elections had already been made. By thereafter refraining from cancelling their elections, made in prior years, the insured policyholders whose policies subsequently matured in 1933, thereby accepted the petitioner's offer to pay, in the event of such maturity, excess interest dividends in 1933, at the specific rate declared for that year.

The petitioner's declaration at the beginning of 1933, that it would pay excess interest dividends in that year, at a specific rate, for its use of funds held during that year under supplementary contracts, was, therefore, the offer from which these *new* supplementary contracts arose, and *but for which* the petitioner would not have been permitted, under those contracts, to retain and use the proceeds of policies maturing in 1933. As noted above, and as shown

under Point II, *infra,* the findings of fact show that these *new* contracts accounted for at least 20% of all funds upon which the petitioner paid the excess interest dividends here involved.

In view of these facts it is difficult to conceive upon what basis the Circuit Court below described the payment of this excess interest as (R. 133):

> "a payment which may be made or withheld at the will of the directors of the company."

It is equally difficult to discern a basis for that remark in respect of the excess interest paid on 42.99% of the remaining funds which were held under supplementary contracts issued in prior years. This percentage of the total funds upon which petitioner paid the excess interest dividends here involved was held under option 1, elected, not by the *insured,* but by the *beneficiaries* (R. 70, 121). These *beneficiaries,* having power to withdraw their funds at will, left the funds "on deposit with the Society at interest" *after the petitioner, at the beginning of 1933, had declared the specific rate at which it would pay excess interest for its retention and use of such funds in 1933* (Point III, *infra*).

The petitioner held the balance of the funds, upon which the excess interest dividends involved were paid, under supplementary contracts issued in years prior to 1933, under which the beneficiaries may or may not have had the power to withdraw funds at will. But even when the beneficiaries had no powers of withdrawal under these prior contracts, the petitioner was under an equally binding legally enforceable contractual obligation to pay excess interest *at the specific rate determined and declared* for 1933. This is so because, as shown under Point IV, *infra,* the petitioner, in issuing these supplementary contracts in prior years had not only guaranteed to pay interest at the minimum rate of 3% throughout the life of the contract,

but also had made the conditional promise that, if, in any following year, it should offer to pay a higher gross rate of interest to obtain new supplementary contracts, it would likewise pay interest at that higher gross rate on these contracts issued in prior years. Under these prior contracts the petitioner had expressly promised that "if *in any year* the Society declares that *funds held under such options* shall receive interest in excess of 3% per annum, the interest * * * shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society" (R. 74, 118A).

Under Point V, *infra*, it will be shown that the Circuit Court below erred in assuming that the 1942 Act, in more clearly providing for this deduction, effected a change in the law, since Congress, when first enacting the provisions for the taxation of life insurance companies, subsequently embodied in the 1932 Act, was aware of the decision in *Lederer* v. *Penn Mutual Life Insurance Co.* (C. C. A.-3, 1919) 258 Fed. 81 at page 92, affirmed on other issues (1920) 252 U. S. 523, expressly holding that these excess interest dividends, when paid by a mutual life insurance company, constituted a payment of interest and not a distribution of profits.

Under Point VI, *infra*, it will be shown that the respondent's own regulations require the allowance of the deduction here at issue.

I.

These excess interest dividends were sums paid by the petitioner for its use and retention of borrowed funds in 1933, and in no sense constituted a distribution of its surplus or earnings of that year or of prior years.

These excess interest dividends, for which the petitioner claims the deduction here at issue, constituted interest paid on indebtedness. As held in *United States* v.

Heilbroner (C. C. A.-2, 1938) 100 F. (2d) 379 at page 381, both the guaranteed interest and the excess interest dividends paid by mutual life insurance companies upon funds held under supplementary contracts constitute "sums paid by the companies for the retention and use of the face amounts of the various policies," and are "fairly within the meaning of the word 'interest' " as used in the revenue acts. In that case, AUGUSTUS N. HAND, Circuit Judge, speaking for the court said (100 F. [2d] 379 at p. 381):

> "The items aggregating $19,109 paid to the defendant during the year 1931 constituted the amounts due her that year both as to the guaranteed minima and as dividends apportioned to the respective policies.
>
> * * * * * * * * *
>
> "It is unimportant that no trust was created here and that the beneficiary was to receive not only 3% but any increased amounts voted as dividends. *The payments were in either event solely for the use of money* ultimately payable without depletion to designated beneficiaries, *and were fairly within the meaning of the word 'interest'.*" (Italics supplied.)

The so-called excess interest dividends, involved herein, were not paid in one sum but were paid, *as they accrued*, with each monthly or other instalment as such instalments became due (R. 74, 118A). They "accrued during the year" (R. 72, 113), and *solely upon the basis of funds held during the year* under the respective supplementary contracts (R. 74, 118A). They bore no relation to funds held by the petitioner in prior years which may have contributed to the petitioner's earnings and profits of those prior years (R. 113, 118A, 122).

On each of two supplementary contracts of the same type and for the same principal amount, held for six months during 1933, the same amount of excess interest dividends was paid for that year regardless of the fact that one contract may have been derived from a new

policy which had not been issued until after the beginning of that year, covering an insured who subsequently died in that year; and that the other was derived from a policy which had matured twenty years earlier (R. 118A, 122).

In disallowing the deduction claimed for these excess interest dividends, the Tax Court based its decision below on its prior decisions in *Penn Mutual Life Insurance Co. v. Commissioner* (two cases), 32 B. T. A. 839 and 876, aff'd on this issue (C. C. A.-3, 1937) 92 F. (2d) 962 and 972, where the Tax Court said (32 B. T. A. 839 at p. 851):

> "At any rate, what was paid amounted to nothing more than voluntary distributions of earnings."

In the *Penn Mutual* cases, the Circuit Court of Appeals for the Third Circuit affirmed the Tax Court's decision disallowing a deduction for the excess interest dividends there involved, saying (92 F. [2d] 962 at p. 970):

> "Section 1 of each policy is entitled '*Participation—Dividends of Surplus.*' The addition of 1.85 per cent *is awarded by the trustees from surplus* and only under circumstances which, in the opinion of the board of trustees, justify the addition. * * * Under the circumstances, the making of the award is in substance the declaration of a dividend." (Italics supplied.)

In affirming the Tax Court's decision on the issue now before this Court, the Circuit Court of Appeals cited, with apparent approval, the decisions of the Third Circuit in these *Penn Mutual* cases.

In the *Penn Mutual* cases, the facts there involved may have justified the decisions there reached and the statements quoted above from the opinions of the Tax Court and the Circuit Court of Appeals for the Third Circuit. The quoted excerpt from the Circuit Court's opinion in that case implies that the provisions for the excess interest

dividends, there involved, were expressly called *"Participation-Dividends of Surplus,"* and states as a fact that they were *"awarded * * * from surplus."*

In the instant proceeding, however, *the facts affirmatively show* that the excess interest dividends here involved constitute neither a distribution of surplus nor a sha ing of earnings.

Nothing in the petitioner's supplementary contracts, nor in the policy provisions from which they were derived, mentions *surplus* or in any way conditions the petitioner's undertaking on the existence of a surplus (R. 69, 73, 74, 109, 118A).

Nor was the petitioner required to have any surplus at all in order to contract at the beginning of 1933 to pay these excess interest dividends in that year at the specific rate then determined and declared. No such requirement is made in the statutory provision which authorized the provisions in the petitioner's policies from which these supplementary contracts arose. *Section 83(3) of the New York Insurance Law* (as in effect throughout the taxable year 1933) which provided (italics supplied):

> "* * * Both participati g and non-participating policies may provide that in addition to the rate of interest guaranteed by the company to be paid on deferred payments of the proceeds, excess interest may be paid thereon at such rate as the company may annually declare, *and the inclusion in any non-participating policy of such provision shall not be construed to make the policy participating.* * * *"

This statute authorized the petitioner's issuance of *new* supplementary contracts in 1933 expressly providing for *the specific rate* of excess interest for that year which had been determined and declared at the beginning of that year, *regardless of whether the petitioner had any surplus at the beginning of 1933 or at any other time during that year.*

The petitioner's undertaking to pay excess interest dividends in 1933, as they might accrue during that year at the specific rate determined at the beginning of that year, was conditioned only upon the petitioner's retention in 1933 of funds held under these contracts (R. 70, 73, 74, 110, 118A). This undertaking was not made with reference to any surplus or earnings of prior years held at the beginning of that year, nor was it conditioned upon the continued existence of any surplus.

These facts negative the idea that the petitioner's payment of excess interest dividends on its supplementary contracts constituted a distribution of surplus or of earnings of prior years. Furthermore, these excess interest dividends, as provided in the supplementary contracts, accrued to the credit of and were paid to *beneficiaries* who were *not entitled to share in the petitioner's surplus.* See: *Mayer* v. *Attorney General*, 32 N. J. Eq. 815, discussed below.

Nor did these excess interest dividends, so-called, constitute a distribution of earnings for the current year. The only "earnings" mentioned in these provisions for optional modes of settlement are the earnings which the beneficiaries of the contracts will enjoy at the guaranteed minimum return at 3%, i. e. the "interest earning of 3% per annum" (R. 74, 118A). Quite obviously this is not the rate the petitioner expected to realize from the investment of these funds, for "3% per annum" was the guaranteed minimum return to the beneficiaries, and nothing in these agreements could justify the conclusion that the petitioner was undertaking to pass on to them the full earnings, either net or gross, which it expected to realize from its retention and use of the funds involved.

That these so-called excess interest dividends did not constitute a sharing of the earnings of the current year is apparent because the specific rate at which they were to be

paid was determined and declared *at the beginning of the year* and was not conditioned upon the petitioner's profits or earnings for the year (R. 112, 118A). The petitioner's undertaking to pay this excess interest for 1933, at the specific rate determined and declared at the beginning of that year, was a promise to pay this interest at that rate regardless of whether the petitioner's general business for the year, or its retention and use of the particular funds involved, might result in a profit or a loss.

As stipulated by the parties (R. 110) and as found by the Tax Court (R. 70):

> "The obligations arising under these option contracts were absolute obligations of the petitioner and were not in any sense contingent upon the happening of future events."

Being neither a distribution of the profits or surplus of prior years, nor a distribution of the earnings of the current year, it would seem to follow, necessarily, that the petitioner's payment of the excess interest dividends, for which it claims the deduction here at issue, constituted a payment of interest on indebtedness.

This is consonant with the decision below (R. 132) holding that the petitioner is entitled to a deduction for the so-called guaranteed interest paid on the total funds held under these contracts. This decision necessarily includes a holding that the petitioner's liability in respect of these funds constitutes "indebtedness" within the meaning of Section 203 (a) (8) of the Revenue Act of 1932. The only *guarantee* involved in this so-called "guaranteed interest" was that the minimum rate at which interest would be paid throughout the life of the contract would be 3% (R. 118A). The so-called excess interest dividends, being merely a device to vary this rate for those years in which these funds "shall receive interest in excess of 3% per annum" (R. 118A), were obviously paid for the same

purpose as the guaranteed interest and upon the same indebtedness.

That these so-called excess interest dividends constitute *interest paid on indebtedness* and not a distribution of profits is consonant with the statutory provision authorizing the petitioner's issuance of the policies from which these supplementary contracts were derived: *Section 83 (3) of the New York Insurance Law* (as in effect throughout the taxable year involved) which expressly provided that:

> "* * * the inclusion in any non-participating policy of such provision shall not be construed to make the policy participating. * * *"

The excess interest dividends accrued to the credit of and were paid to *beneficiaries* not *policyholders*. That the payment of the so-called excess interest dividends, therefore, did not constitute a distribution of profits, is indicated by the distinction between *policyholders* and *beneficiaries* which this Court pointed out in *Duffy* v. *Mutual Benefit Life Insurance Co.* (1926) 272 U. S. 613 at page 618; and by the decision in *Mayer* v. *Attorney General*, 32 N. J. Eq. 815 at pages 820 and 821, which turned on this distinction. In the *Mayer* case, cited and quoted with approval by this court in the *Duffy* case, the court pointed out that *policyholders* may (32 N. J. Eq. 815, at p. 820):

> "* * * be deemed and taken as members of said corporation. As such members they managed the business through their agents, * * *."

In holding that upon the insolvency of a mutual life insurance company, the *beneficiaries* were entitled to a preference over *policyholders*, because, on maturity of each policy, the company's obligation thereunder, to the *beneficiary*, became a debt, the court said (32 N. J. Eq. 815 at p. 821):

> "By such a change it became *a debt owing by the company to a third party*, not bound to make further payments of premiums, and *not entitled to act in the management of the business.* The amount of

such debt *was not subject, in the legitimate conduct of the business, to its risks.*" (Italics supplied.)

The *beneficiaries* to whom this petitioner paid the so-called excess interest dividends, involved in this proceeding, therefore, were not entitled to share in the petitioner's profits since the petitioner's obligation under each of their respective supplementary contracts was "*a debt owing by the company to a third party*" whose funds, held by the petitioner under that contract, were "*not subject,* in the legitimate conduct of the business, *to its risks.*" *Mayer* v. *Attorney General,* 32 N. J. Eq. 815; cited with approval by this Court in the *Duffy* case, 272 U. S. 613 at page 618, *supra.*

As held in *Lederer* v. *Penn Mutual Life Assurance Co.* (C. C. A.-3, 1919) 258 Fed. 81 at page 92, affirmed on other issues (1920) 252 U. S. 523, the excess interest paid by a mutual life insurance company on its supplementary contracts, there called "Trust Certificates," does not constitute a dividend either in an insurance or a commercial sense and was therefore deductible under Section II G (b) of the 1913 Act (38 Stat. 172, 173) which expressly prohibited the deduction of dividends.[3]

In view of the foregoing, it is respectfully submitted that the Tax Court's decision in *Jefferson Standard Life*

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[3] The undisputed testimony in that case shows that the interest there held to be deductible was excess interest over and above any guaranteed rate. See page 57 of the Transcript of the Record in *Penn Mutual Life Insurance Co.* v. *Lederer* (October Term, 1919, No. 499) 252 U. S. 523, where it appears that Frederick H. Garrigues, Mathematician of the Penn Mutual Life Insurance Co. testified as follows with reference to this interest:

> "The Board, realizing that that fund was invested among the Company's assets, thought that the beneficiaries should have their fair share of such interest, and it was awarded to them, * * *"

In the *Penn Mutual's* "Trust Certificates" the *guaranteed* interest is included in and is a part of the face amount of each instalment. See the description of these same "Trust Certificates" in the Board's findings of fact in *Penn Mutual Life Insurance Co.*, 32 B. T. A. 839, affirmed in part and reversed in part (C. C. A.-3, 1937) 92 F. (2d) 962.

It should be noted that in this later case involving the *Penn Mutual* the earlier decision in the *Lederer* case allowing the deduction of the excess interest paid on these same Trust Certificates by this same mutual life insurance company was not called to the attention of the Circuit Court of Appeals.

Insurance Co. v. *Commissioner* (1941) 44 B. T. A. 314, in which the respondent has acquiesced (C. B. 1941-2, p. 7), is correct in so far as it holds that a *stock* life insurance company is entitled under Section 203 (a) (8) of the Revenue Act of 1932 to a deduction for interest paid on indebtedness in the amount of the excess interest paid by the company in 1933 on funds held under its supplementary contracts.

As shown above, excess interest so paid constitutes a distribution neither of surplus nor of earnings, but is the consideration paid by the life insurance company for its retention and use of the funds held. This is true whether the life insurance company be a *stock* or a *mutual* company. As the Circuit Court itself points out, in its opinion below (R. 133), Congress did not intend to distinguish between *stock* and *mutual* life insurance companies in the allowance of this deduction. That in the taxation of life insurance companies Congress did not intend to differentiate between *stock* and *mutual* life insurance companies, has been noted by this Court: *Penn Mutual Life Insurance Company* v. *Lederer* (1920) 252 U. S. 523 at page 535.

The meaning of Section 203 (a) (8) of the 1932 Act is not doubtful. It expressly provides a deduction for the petitioner in the amount of:

> "All interest paid or accrued within the taxable year on its indebtedness * * *"

The Circuit Court, in this proceeding (R. 132), has held that the petitioner's liability under its supplementary contracts constitutes "indebtedness" within the meaning of this provision; and in *United States* v. *Heilbroner* (C. C. A.-2, 1938) 100 F. (2d) 379 at page 381, *supra,* has held that the excess interest dividends paid on such contracts, by mutual life insurance companies, constitute "sums paid by the companies for the retention and use of the face amounts of the various policies * * * pay-

ments * * * solely for the use of money" which are "fairly within the meaning of the word 'interest.'"

The facts in this case, as stipulated by the parties and found by the Tax Court, which have been discussed above, clearly affirm that the excess interest dividends paid by the petitioner in 1933 for its retention and use of funds held under supplementary contracts, are likewise "payments * * * solely for the use of money" and are "fairly within the meaning of the word 'interest'" as that term is used in Section 203 (a) (8) of the Revenue Act of 1932.

It is respectfully submitted, therefore, that the Circuit Court erred in failing to allow the deduction claimed.

II.

The petitioner made an offer to pay *interest* at a *specified* excess *rate* for its retention and use of funds held under supplementary contracts in 1933, and as to funds held under all new supplementary contracts issued in 1933, the petitioner's offer was accepted, *thereafter,* either by the respective policyholders or by their beneficiaries, and resulted in a legally binding contractual obligation on the part of the petitioner to pay this *interest* at the *excess rate specified* for its retention and use of such funds in that year.

The issuance of supplementary contracts constitutes an important part of the business of life insurance. *Spectator Compendium of Official Life Insurance Reports,* 1941, page 136A. At the beginning of 1933, the petitioner knew that during the next twelve months approximately 15,000 of its policies would mature by the death of the insured and approximately 4000 more would mature as endowments. *Insurance Year Book 1934, Life Insurance* (The Spectator Co.) page 331. Presumably the petitioner desired to retain the proceeds of those policies under supplementary contracts. See: William K. Miller, *Supplementary Con-*

tracts, Life Officers Management Association (1935), V. 1, page 160 at page 161.

It is the custom of all life insurance companies to determine and declare *at the beginning of each year* the gross rates (i. e. *guaranteed minima* plus *specific* rates in excess of those *minima*) at which they, respectively, will pay interest for that year's retention and use of funds held under supplementary contracts.[4]

In accordance with this custom, the petitioner, *at the beginning of 1933*, determined and declared *the specific rate* at which it would pay excess interest for its retention and use in that year of funds held under supplementary contracts (R. 112). This action on the part of the petitioner was obviously intended and designed to encourage policyholders and policy beneficiaries to exercise options permitting the petitioner to retain the proceeds of policies which might mature in that year, and to refrain from cancelling the elections of such options where such elections had already been made.

The petitioner's determination and declaration at the beginning of 1933 of the specific rate at which it would pay excess interest for its retention and use of such funds in that year was obviously an offer to pay excess interest at that specific rate for the privilege of retaining such funds during that year. This offer was intended to constitute and did constitute the basis of the new supplementary contracts which came into being that year (R. 112, 113, 118A, 122).

Since the petitioner's determination of this specific rate of excess-interest for 1933 was made at the very beginning of that year (R. 112), it follows that all new supplementary contracts issued that year were issued with the mutual understanding that, regardless of what might happen in

[4] e. g. See: *Best's Insurance News, Life Edition,* Vol. 44, No. 9, pages 38 and 39, where the gross rates at which practically all life insurance companies will pay interest, respectively, for their retention and use of such funds in 1944 were published in January, 1944.

subsequent years, the petitioner would pay excess-interest *at the specific rate determined for 1933* for its retention and use during that year of the proceeds of the policies from which these contracts were derived.

In determining that rate at the beginning of the year the petitioner had made an offer. By thereafter electing options for deferred payment of the proceeds of their policies or by refraining from cancelling such elections already made, the insured or their beneficiaries, as the case may be, accepted this offer. By the resulting supplementary contracts the petitioner was legally obligated to pay excess interest at the *specified* rate for its retention and use in 1933 of the proceeds of the policies from which these new supplementary contracts were derived.

The findings of facts do not show what portion of the funds, held by the petitioner at the end of the year, represented new contracts which had been issued during the year; but they do show that, at the end of the year, the funds held by the petitioner, under all the supplementary contracts here involved, were $7,520,481.00 in excess of the amount of such funds held at the beginning of the year (R. 69, 109).

Unstipulated, but, presumably, large amounts of the funds held at the beginning of the year were paid out *during the year* under the various instalment options. If such amounts were exactly equal to the funds held at the end of the year, under new supplementary contracts which had been issued during the year, the petitioner would have held exactly the same amount, at the end of the year, as it had held at the beginning of the year, under the supplementary contracts here involved. But at the end of 1933 the petitioner held $42,326,682.00 under supplementary contracts of all types here involved, whereas at the beginning of that year it had held but $34,806,201.00 under such contracts (R. 109). The *findings of fact* thus show that as a result of *new* supplementary contracts which had been

issued during the year, the petitioner, at the end of the year, held $7,520,481.00 *in excess* of all the principal which had been paid out during the year, under contracts which had been issued in prior years. As a matter of fact, of the funds involved herein, the petitioner held $15,044,700 or 40%, of the total, under *new* supplementary contracts issued in the year 1933. See: *Insurance Year Book 1934, Life Insurance* (The Spectator Co.) page 330.

The findings of fact do not show the total funds held under *new* contracts, but, as noted above, they do show that more than 20% of all funds held by the petitioner in 1933 under the supplementary contracts here involved were held under *new* contracts which had been issued in that year and which had been entered into with the mutual understanding that excess interest *at the specific* rate determined for 1933 would be paid by the petitioner for its retention and use in 1933 of the proceeds of the policies from which these contracts were derived.

As to these new contracts, petitioner's payment of excess interest dividends in 1933, at the specific rate determined for that year, was clearly the performance of a legally binding contractual obligation to pay *interest* at this *specified* excess rate.

Furthermore, it is reasonable to assume, and for the purposes of this case it should be assumed, that *but for* the petitioner's declaration at the beginning of that year, that it would pay this *interest* at the excess rate then *specified*, these new supplementary contracts would not have been entered into.

III.

There was a valid acceptance in 1933 on the part of many beneficiaries of supplementary contracts issued in prior years, of the petitioner's offer, made at the beginning of that year, to pay *interest* at a *specified* excess rate for its retention and use during that year of funds held under their respective contracts; and legally binding contractual obligations to pay this *interest* at that *specified* excess rate resulted.

Where an installment type option had been elected *by the insured,* the beneficiary had no right to terminate the contract and receive the principal amount thereof, *unless the insured had so provided* (R. 118A).

The stipulated facts do not indicate what proportion of the funds held under options exercised by the insured, could have been withdrawn by the beneficiaries on demand pursuant to provisions therefor made by the insured. Presumably some portion of those funds could have been so withdrawn. The provision for this right of withdrawal was so customary that in subsequent years the companies have been forced to offer higher rates of excess interest for the relinquishment of this right. *Best's Insurance News, Life Edition,* vol. 44, No. 9, January 1944.

Where instalment options had been exercised by the beneficiaries (options 2 and 4, R. 118A) the beneficiaries presumably had reserved the right to terminate the contract and withdraw the principal amount on demand, regardless of what option had been elected. Indeed, the italicized provision in these options stating that "*No option of settlement elected by the Insured hereunder can be changed nor can any payment thereunder be commuted except by the Insured's written order,*" would seem to imply that, where the *beneficiaries* elected the options, they would have this right of withdrawal without express reservation.

But even assuming that only in those cases where the *beneficiaries* had elected to leave the proceeds of the policies "on deposit with the Society at interest" (option 1, R. 118A), did they have the right to withdraw the principal amount of the contract at any time, this would mean that 42.99% of the funds held by the petitioner under supplementary contracts could have been so withdrawn (R. 70, 121).

The petitioner's offer *made at the beginning of 1933* to pay excess interest *at a specified rate* for its retention and use of these funds during that year was unquestionably designed and intended to discourage the withdrawal of these funds. By refraining from exercising their right to withdraw these funds and by continuing to leave the funds "on deposit with the Society at interest," *after the petitioner had declared the specific rate* at which it would pay excess interest on these funds in 1933, these beneficiaries accepted the petitioner's offer to pay that excess interest at that specified rate for its retention and use of these funds during 1933. A legally binding contractual obligation to pay this *interest* at that *specified* excess rate resulted.

But for the petitioner's declaration at the beginning of that year, that it would pay this *interest* at that *specified* excess rate, it is reasonable to assume, and should be assumed, that the petitioner would not have been permitted to retain and use these funds during that year.

IV.

On the remaining funds, which were held under supplementary contracts issued prior to 1933 for beneficiaries who had no right to withdraw, the petitioner had always been under a *conditional,* but nevertheless legally binding, contractual obligation to pay *interest* in 1933 at a *specific* excess rate to be determined by subsequent events; and at the beginning of 1933 that *specific* rate was determined and the petitioner's obligation to pay this *interest* became absolute.

At the beginning of 1933, the petitioner was, of course, under no legally binding obligation to *offer* to pay excess interest for the year, at any specific rate, on *new* contracts which might thereafter be entered into. Nor was it under any obligation to determine and declare a specific rate at which it would pay excess interest for that year on contracts theretofore issued.

Under those prior contracts the petitioner had undertaken to pay excess interest only "*if* in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum". The rate for any year at which excess interest, *if any,* would be paid, both on new supplementary contracts to be entered into and on old supplementary contracts already issued, was the rate which the petitioner in its *sole discretion* would determine and declare.

Nevertheless, the petitioner's undertaking to pay excess interest was not an illusory promise. It was in effect a promise to pay excess interest on these contracts in future years at the respective rates which the petitioner would offer in those years for new contracts of the same type *if the petitioner wanted to continue this branch of its business.*

Under these supplementary contracts issued in prior years, the petitioner had expressly promised that "if *in*

any year the Society declares that *funds held under such Options* shall receive interest in excess of 3% per annum, the interest * * * shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society" (R. 74, 118A). In other words, the petitioner, in issuing these supplementary contracts in prior years, had not only guaranteed to pay interest at the minimum rate of 3% throughout the life of the contract, but also had made the conditional promise that, if, in any following year, it should offer to pay a higher gross rate of interest to obtain new supplementary contracts, it would likewise pay interest at that higher gross rate on these contracts issued in prior years.

In this respect the petitioner's undertaking is analogous to that of the auto manufacturer in *Moon Motor Car Co. of New York* v. *Moon Motor Car Co., Inc.* (C. C. A.-2, 1928) 29 F. (2d) 3 at page 4, of which L. Hand, Circuit Judge, speaking for the Court said:

> "The maker promised not to sell any cars within the specified district, except to the dealer, who in turn promised to buy 900 cars, to sell no other make of cars anywhere, to set up a shop, and to push the sales. These promises were given in exchange for each other and created a contract; of so much there can be no doubt.
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> * * * * * * * *
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> "Suppose that the dealer has promised to buy, and the maker has not promised to sell. Nevertheless the dealer had his monopoly by virtue of which the maker must sell to him, if he would sell at all. The contract had been in force for more than three years, and had only seven months to run; we cannot say that it was an impossible task to show, with certainty enough to support a verdict, how many cars the maker would in fact have delivered under the pressure of this limitation, even though he was not legally bound to deliver any at all."

In the *Moon Motor Car Co.* case, the auto manufacturer was not legally bound to sell his dealer any cars at all. In the instant proceeding, the petitioner was not legally bound to determine and declare any excess interest for 1933 at all. But if the petitioner was to offer any excess interest for that year in order to obtain new contracts, it would have to pay the same excess interest on prior contracts; just as in the *Moon Motor Car Co.* case, if the auto manufacturer was to sell any cars at all in his dealer's territory, he would have to sell those cars to his dealer.

The policyholders and beneficiaries who had elected the options leading to those prior contracts could rely upon the petitioner being just as anxious to retain and use the proceeds of policies maturing in future years as it was to retain and use the proceeds of policies in those years in which their contracts were issued. To obtain new contracts in future years the petitioner would have to determine and declare excess interest dividends at specific rates sufficiently high to make the gross rates substantially equivalent to the going rates on money for those future years. But the petitioner could not determine and declare a rate for excess interest dividends on new contracts, for any year, without obligating itself to pay excess interest at that same rate on contracts theretofore issued. In view of "the pressure of this limitation," the policyholders and beneficiaries, in entering into these supplementary contracts in prior years, had a reasonable expectation of receiving *interest* at satisfactory excess rates in the years to follow, *including the year 1933;* and it cannot be said that the petitioner's undertaking to pay this *interest*, at *specific* excess rates to be subsequently determined, was an illusory promise. *Moon Motor Car Co. of New York* v. *Moon Motor Car Co., Inc.* (C. C. A.-2, 1929), *supra.*

True it was a conditional promise. But it is elementary law that a conditional promise is good consideration for a

contract, and is enforceable upon the happening of the condition. See: *Restatement of the Law of Contracts,* §§ 77, 79.

Performance of this conditional promise was at the option of the petitioner since it was within the power of the petitioner to see that the condition never happened. But the promise of either party to a contract may be optional if the exercise of the option not to perform involves a detriment to the promisor. *Moon Motor Car Co. of New York* v. *Moon Motor Car Co., Inc.* (C. C. A.-2, 1928) 29 F. (2d) 3, *supra.* For other cases see: *Note, A Promise Dependent on a Subjective Contingency as a Cause of Action and as a Consideration* (1926), 26 Col. L. Rev. 724. And see: *Restatement of the Law of Contracts,* § 79.

As stated in *Williston on Contracts* (1936, revised ed.) vol. 1, Sec. 104, at page 351, with reference to employment contracts:

> "The promise of either party may be optional, if the exercise of the option not to employ or to serve involves a detriment to the promisor, or a benefit to the promisee."

In the supplementary contracts which petitioner had issued prior to 1933, petitioner made an apparent promise to pay excess interest for 1933 on the funds held in that year under such contracts, at the specific rate to be determined and declared by the petitioner in that year for new supplementary contracts to be issued in that year, *unless* the petitioner should decide not to issue new contracts that year. Though the petitioner could have refused to determine and declare a specific rate of excess interest for 1933, it could not then have kept its promise except by not offering to pay gross interest in excess of 3% on new contracts to be issued that year. That would have made it difficult if not impossible for the petitioner to obtain new

business in that year in supplementary contracts; and would, itself, have been a sufficient consideration had it been bargained for. See: illustration 2 under § 79 of the *Restatement of the Law of Contracts.*

When the petitioner, at the beginning of 1933 (R. 112) determined and declared the specific excess rate at which it would pay *interest* for its retention and use in that year of funds thereafter left with it under supplementary contracts, the condition, which had theretofore limited its promise to pay *interest* at an excess rate in that year on prior contracts, happened. Thereafter it was obligated under those prior contracts to pay *interest* in 1933 at the specific excess rate determined and declared for that year.

As the Court in *Moon Motor Car Co. of New York* v. *Moon Motor Car Co., Inc.* (C. C. A.-2, 1928), 29 F. (2d) 3 at page 4, said:

> "There is no objection to a promise that it is indefinite so long as the parties can tell when it has been performed, and it is enough if, when the time arrives, there shall be in existence some standard by which that can be tested."

Accordingly, even as to those contracts under which the beneficiaries had no right to withdrawals in 1933, the petitioner's payment of excess interest at the rate determined and declared for its use and retention of funds in that year under supplementary contracts, was in no sense a voluntary distribution, but was the performance of a legally binding contractual obligation to pay *interest;* and, presumably, *but for* the petitioner's conditional promise to pay this *interest,* these older, supplementary contracts would not have been entered into.

V.

The Circuit Court below erred in assuming that, on the issue here involved, the Revenue Act of 1942 effected any change in the law.

In its opinion below, the Circuit Court assumes (R. 133) because Congress, in the 1942 Act, has more clearly provided for the deduction of excess interest dividends paid by life insurance companies on funds held under supplementary contracts, that, in this respect, the enactment of the Revenue Act of 1942 effected a change in the law.

In this, it is respectfully submitted, the Circuit Court erred. Section 203 (a) (8) of the Revenue Act of 1932 under which the deduction here involved is claimed, is a *verbatim* re-enactment of section 245 (a) (8) of the Revenue Act of 1921 (42 Stat. 261), then first enacted as part of the plan for taxing life insurance companies subsequently embodied in the 1932 Act. This provision was originally enacted in 1921 after Congress, through the Ways and Means Committee, had been informed "of the decisions of the United States courts * * * under the internal revenue acts from 1909 to 1919," including the decision in *Lederer* v. *Penn Mutual Life Insurance Co.* (C. C. A.-3, 1919), 258 Fed. 81, *supra*, which, the Ways and Means Committee was advised, had held that excess interest paid by a mutual life insurance company on its supplementary contracts is deductible under those acts on the ground that "*interest* so paid is not a dividend." *Notes on the Revenue Act of 1918* (Printed for the Use of the Committee on Ways and Means) *Part I, page 3 and Part II, page 76.*

Nothing in the enactment of the 1942 Act can be deemed to limit the corresponding provision of the 1932 Act in respect of the taxable year 1933. As this Court, in *Penn Mutual Life Insurance Co.* v. *Lederer* (1920) 252 U. S. 523, at pages 537 and 538, pointed out:

"The legislative history of an act may, where the meaning of the words used is doubtful, be resorted to as an aid to construction. * * * But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question."

Furthermore, the meaning of Section 203 (a) (8) of the 1932 Act is not doubtful. It expressly provides a deduction for the petitioner in the amount of:

"All interest paid or accrued within the taxable year on its indebtedness * * *"

and as shown under Point I, *infra,* the petitioner's obligations under the supplementary contracts, here involved, constituted "indebtedness"; and the excess interest dividends, for which it claims the deduction here at issue, constituted "interest" paid on this indebtedness; all within the meaning of the quoted provision of Section 203 (a) (8) of the Revenue Act of 1932.

It is respectfully submitted, therefore, that the deduction claimed, is one within the clear meaning of the quoted statutory provision, and nothing in the enactment of the Revenue Act of 1942 can be deemed to change this clear meaning.

VI.

The respondent's own regulations require the allowance of the deduction claimed in the amount of the excess interest dividends paid by the petitioner on its supplementary contracts in 1933.

In construing Section 203 (a) (8) of the Revenue Act of 1932, Article 975 of Treasury Regulations 77, as added in 1935 by TD 4615, CB, XIV-2, page 310 at page 312, provides:

"(4) if a life insurance company pays interest on the proceeds of life insurance policies left with it pursuant to the provisions of supplementary contracts, not involving life contingencies, or similar contracts, the interest so paid shall be allowed as a deduction from gross income, except that such deduction shall not be allowed in respect of interest accrued in any prior taxable year to the extent that the company has had the benefit of a deduction of 4 per cent or 3¾ per cent, as the case may be, of the mean of the company's liability on such contracts, by the inclusion of such liability in its reserve funds."

This regulation, like the Act itself, provides quite simply and clearly that if the petitioner pays interest on the indebtedness represented by the supplementary contracts here involved, it shall receive a deduction in the amount of the interest so paid.

Nothing in the quoted regulation attempts to bar a deduction for conditional interest so paid; and any such attempt would be invalid provided that at the time of payment the limiting condition had happened and the liability to pay the interest was absolute as in the instant proceeding. See: *Mertens on the Law of Federal Income Taxation* (1942) vol. 4, page 544, note 40, where it is stated:

"If there is a conditional primary indebtedness, payments which are alleged to represent interest are not deductible. If, however, there is a fixed obligation to pay the principal amount, payments of 'interest' on such amounts will be deductible even though the liability to pay such interest does not arise until a date subsequent to that on which the primary indebtedness arose."

Conclusion.

The excess interest dividends paid by the petitioner in 1933 pursuant to its supplementary contracts, were sums paid by the petitioner for its retention and use of funds held under those contracts. These sums constituted interest paid by the petitioner within the taxable year on its indebtedness, for which a deduction is provided by Section 203 (a) (8) of the Revenue Act of 1932.

It is, therefore, respectfully submitted that the judgment of the court below, on the issue here involved, should be reversed.

Respectfully submitted,

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